Crescent Point Energy Corp.: Is the 10% Dividend Really Safe?

Description

Crescent Point Energy Corp. (TSX:CPG)(NYSE:CPG) has refused to cut its dividend during the recent rout in oil prices, but the lofty 10% yield has many pundits thinking its just a matter of time.

Let's take look at the situation to see if the dividend is at risk and decide whether you should consider adding Crescent Point to your portfolio.

Dividend history

Crescent Point has a history of maintaining its payout during tough times. When oil prices dropped to $45 in the darkest days of the Great Recession, Crescent Point took the position that the slide in prices would be short lived and decided to maintain the distribution.

The big dividend payment has always been an important and controversial part of Crescent Point's business model. The company uses the generous distribution as a carrot to attract investors when it needs to raise capital for acquisitions and development projects.

Many analysts are uncomfortable with this approach because the company has historically paid out more dividends than can be supported by its cash flow.

As long as the market is always willing to buy new stock, the model works well, but confidence in the management's ability to protect the payout is extremely important.

Oil market

During the Great Recession, oil companies believed that low prices would be a short-term event, and it turned out they were right. This time, however, the reason for the fall in oil prices is very different, and a V-shaped recovery is less certain.

Record U.S. production is pushing storage capacity to the brink. At the same time, global producersare stubbornly defending their market share and refusing to reduce output. This game of chicken couldgo on longer than initially thought, keeping oil prices at non-profitable levels.

Hedging

Crescent Point has hedged 50% of its oil production for 2015 at prices above $90 per barrel, and 53% of its natural gas output is hedged at $3.60/GJ. This is important because it allows the company to ride out lower prices for another quarter or two.

Production

In January, Crescent Point said it expects production for 2015 to be about 152,500 barrels of oil equivalent per day, which is 9% higher than 2014. The company plans to maintain strong production levels, while cutting capital spending by 28%. Higher output combined with lower expenses will help ease the cash flow squeeze caused by lower prices.

Should you buy?

Any time a dividend hits the 10% mark, investors have to be careful. Crescent Point is determined to maintain the payout and it will probably hold the line for the first half of 2015.

If oil prices drift higher through the back half of 2015, then everything should be fine. If oil takes a run at $40 and stays there for a few months, the company will have to rethink its strategy.

At this point, buying Crescent Point requires a belief that oil prices have bottomed. Given the uncertainty in the market, there is some significant short-term downside risk for the stock. As a long-term bet on a rebound in oil, the company is probably a good investment.

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